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exchange can take place without directly affecting prices. (2) The law of value regulating the existing stock of gold does not change the fact that price is the exchange relation between gold and goods, and not the relation between goods and things other than gold. (3) The equilibrium of buying and selling is maintained according to the exchanges of goods against goods in which money serves only a subsidiary part as a medium of exchange.

J. LAURENCE LAUGHLIN.

AN INCREASE IN GOLD AND THE PRICE-MAKING PROCESS.

THE quantity theory of money has been assailed at various points in recent years, and there is a growing conviction in some quarters that the time-honored theory of Ricardo and Mill is wholly wrong. Without attempting to state all the points at issue, attention will be directed to one of the main questions.

Let us suppose that, owing to the discovery of richer mines or the invention of better mining machinery, there is an increase in the supply of gold in sufficient quantity to raise the general level of prices. According to the older view, this change is brought about by the increase of gold in circulation; that is, by the offer of gold for goods. According to the new view, it is brought about by the fall in the value of gold in the arts.

The argument of the later writers may be briefly stated as follows: The new gold could not increase the circulation, because, the volume of business and the habits of the community remaining the same, no more money would be wanted. Hence, the gold must find its way into the arts. There being no increase in the demand for gold in the arts, any attempt on the part of the holders of gold to dispose of their commodity in that quarter would depress the value of gold in the arts, and the value of the coin would fall as a consequence.¹

The first point in this argument to be considered is the statement that the circulation cannot be increased. Now, it can hardly be denied that if the mine-owners produce more gold than formerly, they could offer it in exchange for goods, and that in the ordinary course of events they would do so. Nor could it be denied that each person who receives the extra gold could and would in turn offer it for goods. The

¹ LAUGHLIN, *Principles of Money*, pp. 339-42. See also GIFFIN, *Case Against Bimetallism*, pp. 81-98.

fact that each one may in time deposit his gold in a bank and offer checks instead of gold does not alter the fact that the producers of the new supply of gold have more of this particular commodity to offer in exchange for any and all other commodities than formerly, and that it would be offered in exchange. An offer of a check based upon gold is an offer of gold as effectively as an offer of the metal itself.

But, it is said, the gold cannot remain in circulation. Now, according to our hypothesis, there is a rise in prices. This is the fundamental fact which we are trying to explain. If the quantity of goods to be exchanged remains the same, and the habits of the people as to the use of money remain the same, there must be an increase in the amount of money in circulation, if prices rise. This is not saying which is cause and which is effect, but merely stating that under the given conditions there must be an increase in the circulation, else there would not be enough money to make the accustomed exchanges. If people exchange the same quantities of goods, and prices are higher, there must be more money to make the exchanges, if all the goods are exchanged with money, or the usual proportion of goods is so exchanged.

Let us now examine the argument that gold would find its way into the arts and depress its value there. By what process could anyone dispose of gold "in the arts" without offering it for goods? There could be only two classes of commodities, gold on one side and all goods on the other. An offer of gold for sale in the arts, therefore, could be nothing but an offer of gold for goods. It would make no difference whether the gold were in coin or in bullion, for buying goods with either coin or bullion is a normal monetary use of the metal.

It is quite evident that this new theory cannot be accepted as a satisfactory explanation of the price-making process. A different one is necessary.

It is conceivable that, in our supposed case of an increase in gold, a rise in prices might be effected in one of three ways: first, the holders of gold might place less value upon their gold and offer more than the usual price for goods; secondly, the holders of goods might directly estimate the gold at a lower value, and consequently charge more for their goods; or, thirdly, the holders of goods might charge more because of an increase in the demand for goods, without directly and consciously considering the value of gold. It may appear at first sight that it would make no practical difference as to which way the change in prices is effected, since there would be the same change in

the ratio in any case. But a moment's reflection will show that there would be a decided difference in the results. If, for example, the change is brought about in the first or second way, the prices of all goods would rise together; but if brought about in the third way, the prices of different kinds of goods would not rise together, as we shall soon see. There would be other important differences, which we need not here indicate.

If there is a fall in the cost of producing an ordinary article, or if there happens to be temporarily an unusually large supply, there is at once a fall in the price of that article. Producers and dealers know that for the present there will be a demand for only a limited quantity of that commodity, and fearing that others may undersell him and supply the demand, each producer or dealer voluntarily offers his goods at a lower price. But gold, as money, satisfies no definite want. No producer of gold fears that the demand for his commodity will be satisfied by other producers, and that he will have left on his hands a useless supply of gold. If indeed there should be such a discovery of gold as to lead to the belief that gold would soon become as plentiful as iron, for instance, the value of gold would suddenly drop, and drop because men would directly value it less. But that would be supposing things different from what they have been or are likely to be. It might be, also, that if the producers of gold desire more of particular kinds of goods, such as mining machinery, and feared that there might be a shortage in the supply, they might voluntarily offer more than the usual price for those goods; but it would not be because they consciously place a lower value upon their gold.

For various reasons it does not seem probable that prices would rise because the holders of goods directly place a lower value upon gold. Manufacturers and merchants know very little about the cost of producing gold, or probable changes in the supply. Nor could they or anyone else tell to what extent a known amount of increase would raise the general level of prices. The purchasing power of gold, and particularly a change in its purchasing power, are very difficult things to determine. The combined wisdom of the world could not nicely estimate the change in prices in the last ten years, to say nothing of forecasting the future. Manufacturers and merchants base their calculations upon something more definite and tangible than changes in the general purchasing power of gold.

Moreover, there are various facts which indicate that people generally think of money as something fixed in value. The common saying

that "a dollar is a dollar" reveals this general state of mind. And the fact that estimates of the probable great increase in the supply of gold in the next few years have not been followed by any sudden rise in prices, furnishes pretty strong evidence in support of this view. It is true that the great mass of existing gold would tend to prevent its value from falling to the same extent as the value of any other commodity would fall as the effect of increased production; but yet there should be a sudden drop to some extent, if men, in practical affairs, tried to estimate changes in the value of gold.¹

It seems, therefore, practically certain that the rise in prices would be brought about by an increased demand for certain kinds of goods. The producers of the extra supply of gold have an increased purchasing power, because the value of gold does not at once fall. With the increase in their command over other goods come new wants and the desire to satisfy old wants more fully. There would therefore be an increased demand for certain kinds of goods. Producers and dealers, perceiving the new demand, and believing that the supply cannot be immediately increased, or increased without greater cost, raise the price of those particular goods.

The increased demand for goods would be followed by an increased supply, which would tend to lower the price. Goods subject to the law of increasing returns would tend to fall even below their former price; goods subject to the law of diminishing returns would tend to remain above their former price; while goods subject to the law of constant returns would tend to return to their former price. But there is one very important item that would affect the price of all goods, even those for which there would be at first no increased demand. That item is wages. There being no increase in the number of laborers, and the arts of production remaining the same, an increase in production would mean an increased demand for labor, which would raise wages. The rise in wages, at first effected in those industries producing the goods for which there was an increased demand, would in time spread to other industries. The rise in wages would increase the expenses of production, and prices of goods not previously affected would rise. It is conceivable that there might be a slight increase in production for a short time without any increase in wages. Mills and factories are seldom running at full capacity, and there are usually idle men. But obviously there is a limit to such expansibility, and if the

¹ W. W. CARLILE, *The Evolution of Modern Money*, p. 287, holds that gold has attained its position as a standard because people believe that gold does not fluctuate.

increased demand for goods is great enough and of long duration, that limit would ultimately be reached, when wages would rise.

The rise in prices and in wages would increase the expenses of mine owners, and consequently lower their profits. Production would cease at the poorest mines, and the supply of gold would decrease. Thus "in the long run" production at the "marginal mine," would indirectly regulate prices.

It thus appears that the rise in prices in the case we have been considering would be brought about by the increase in the circulating medium, that is, by the offer of gold for goods, and that the older writers were therefore correct in this particular instance.

But it also appears that the rise in general prices would be a much more complex process than it appeared to them to be. From what has been said it follows, for example, that even in a condition of money economy, that is, where money is actually used in making all exchanges, the change in the general price-level would not necessarily be *proportional* to the change in the quantity of the medium. As a proposition in logic, it is doubtless true that if there is no increase in the quantity of goods to be exchanged, and no change in the rapidity of circulation, doubling the amount of money in circulation will double price. But the proposition is worthless in practice, because one of the conditions would not remain true. There would be an increased supply of goods. Furthermore, the new demand would not reach all goods equally, as is stated by Mill. This point is so plain that further comment seems unnecessary.

There are doubtless other ideas clinging to the old quantity theory that are not true, but the one proposition which the early writers considered vital, that an increase in the quantity of money in circulation will raise prices, seems to rest on solid ground.

W. S. PARKER.

RELATION OF BUSINESS PROFITS TO INDUSTRIAL DEPRESSION.

AT one or two points Professor Carver's acute and suggestive discussion—in the May number of the *Quarterly Journal of Economics*—on the relation of business profits to industrial depression appears to leave something to be desired. It is true that, with shoes selling at two dollars per pair, the concern which, at that price, has left for itself no margin for dividends (is this quite equivalent to fixing its cost at